

City of Detroit

CITY COUNCIL

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TO: COUNCIL MEMBERS

FROM: Irvin Corley, Jr., Director *ICJ*

DATE: April 24, 2008

RE: Preliminary Review of the 2008-09 Mayor's Recommended Budget

Introduction

The purpose of this memorandum is to provide your Honorable Body a preliminary review of Mayor Kilpatrick's proposed 2008-09 budget that is currently before you for deliberation. My report will focus primarily on:

- Brief overview of the Mayor's proposed budget.
- Reasonableness of General Fund revenue projections.
- Reasonableness of General Fund expenditures.
- Prior year deficit.
- Tunnel deal.
- Observations for FY 2008-09 budget.

Of course, City Council will be receiving more detailed analyses in our departmental budget reports we call "dalies" for the budget hearings, which start this afternoon.

Brief Overview of the Mayor's Proposed Budget

Mayor Kilpatrick's proposed 2008-09 budget is pretty much status quo, and overall, fairly reasonable. There are some soft spots, however, the biggest being the prior year deficit appropriation. The Mayor feels the current fiscal year will end up with a balanced budget. We in Fiscal do not agree with that.

But I will give the Mayor credit in that, for the third year in a row, there are not a huge number of "if comes" and uncertainties in the proposed budget that were presented in his 2005-06 budget.

The Mayor recommends a total budget of \$3.04 billion for fiscal year 2008-09. This is \$68 million lower than the current 2007-08 fiscal year budget of \$3.11 billion dollars.

Usually, the Mayor budgets large bond sales in the Water and Sewerage Department every other year that cause the greatest swings from one budget year to another. 2008-09 is that year; but the Mayor chose not to budget the large bond sales in the 2008-09 budget.

The Mayor recommends a total budget of 15,322 positions in next year's budget. This represents a net increase of 46 positions over the current year's level of 15,276 budgeted positions. Of the Mayor's recommended positions, 8,900 are City funded, 919 are grant funded, and 5,500 are funded by enterprise agencies.

The number of departments remained unchanged in the proposed budget, which is 37 departments. The Mayor proposes no major initiatives such as merging or consolidation of City operations, or regionalization of certain City functions. In addition, the Mayor's proposed budget continues to give emphasis to public safety, a high priority according to citizen surveys.

In regards to the General Fund, the Mayor proposes a General Fund budget of \$1.4 billion for 2008-09, which is \$74 million lower than the current year's budget of \$1.47 billion.

Of course, Police and Fire continues to represent the largest portion of the General Fund budget next year. The departments' combined budget represent approximately 47% of the proposed General Fund budget.

In addition, salary and employee benefits continue to represent the largest portion of the General Fund's budget. These costs constitute about 61% of the General Fund's budget.

Reasonableness of General Fund Revenue Projections

I will briefly talk about General Fund revenues because we will provide more details in our dailies, especially in our analysis of Non-Departmental where the major revenues are budgeted. In addition, the Auditor General will provide a detailed analysis of major revenues in his budget presentation.

But overall, General Fund revenues reduce by \$74 million. This is largely due to the fact that the current year's budget had a \$58 million fiscal stabilization bond sale that Council put into the budget because the proposed tunnel deal was lacking documentation last year. The Mayor does not budget for fiscal stabilization bonds in 2008-09.

When you back out the fiscal stabilization bonds, other overall General Fund revenues reduce by \$16 million next fiscal year, which means that for the most part, the Mayor is being fairly realistic about revenues. However, we do feel that due to the struggling local economy, municipal income tax and casino gaming tax

revenues could shrink even lower than projected in 2008-09. And I must state that we are strongly concerned about the solid waste fee and commercial inspection fee projections in 2008-09 because of poor collection data we see thus far. Another concern we have is the State's ability in keeping state revenue sharing dollars intact next fiscal year for the City of Detroit given the State's economic woes, even though the State is promising to send \$8 million more in these dollars next year to Detroit.

We are pleased to see the Mayor being a little more conservative in his projections of other revenue, such other fees, reimbursements, property sales and fines, in next year's budget. We have felt the Administration has been overly optimistic in its other revenue projections in the past.

Council should note that we are in the process of reviewing supporting schedules for revenues, and how these revenues are supported by data in DRMS, our financial reporting system. We will definitely inform your Honorable Body of any major deviations in our projections versus those of the Administration in the upcoming days.

Reasonableness of General Fund Expenditures

I just want to make a few key points about General Fund expenditures in the Mayor's proposed budget. First, General Fund expenditures reduce by \$74 million primarily due to the Mayor eliminating the prior year deficit appropriation in 2008-09, which we will discuss below.

There is an across the board 4% general wage increase in the budget citywide, including in General Fund departments. Council recently approved this general wage increase for executive branch employees, and would need to approve either a separate resolution, or put it in the budget closing resolution, for legislative employees. The General Fund budget also reflects the increase in Police and Fire salaries due to last year's Act 312 arbitration ruling, which granted a 2 and 3% general wage hike for uniform employees.

The Mayor also increases contractual services, operating supplies and operating services expenditure accounts somewhat in the proposed General Fund budget.

Prior Year Deficit

As Council knows, Mayor Kilpatrick feels the budget will be in balance by June 30, 2008. Therefore, he does not include a prior year deficit appropriation in the 2008-09 General Fund budget. On the other hand, we in Fiscal feel there will be an accumulated deficit of at least \$113 million by June 30, 2008.

Below, we briefly illustrate the difference between the Budget Department's and Fiscal Analysis Division's projections:

Analysis of Surplus/Deficit Projections for Fiscal Years 2007 and 2008
(In Millions of Dollars)

	<u>Budget Department</u>	<u>Fiscal Analysis</u>	<u>Difference</u>
Accumulated Deficit as of 2006 (per CAFR)	\$ (173.70)	\$ (173.70)	\$ -
Operational Surplus/Deficit in 06-07 -(projection)	50.00	(64.90)	114.90
	<u>\$ (123.70)</u>	<u>\$ (238.60)</u>	<u>114.90</u>
Apply Prior Year Deficit Appropriation -2007	-	67.00	
Accumulated Deficit as of 2007 (Projection)	\$ (123.70)	\$ (171.60)	47.90
Operational Surplus/Deficit in 07-08 -(projection)	(5.80)	(29.80)	24.00
	<u>\$ (129.50)</u>	<u>\$ (201.40)</u>	<u>71.90</u>
Apply Prior Year Deficit Appropriation -2008	88.60	88.60	-
	<u>\$ (40.90)</u>	<u>\$ (112.80)</u>	<u>71.90</u>
Property Sales Surplus -projected	9.00	-	
Tunnel Sale Surplus - projected	7.00	-	
Police & Fire Pension Funding Credit - projected	25.00	-	
Accumulated Surplus/Deficit as of 2008 (Projection)	<u>0.10</u>	<u>(112.80)</u>	<u>112.90</u>

Some crucial points I would like to make:

1. Budget projects a \$50 million surplus for fiscal year 2006-07; Fiscal projects a \$65 million deficit for 2006-07. We are waiting for more details from Budget to see if we can reconcile our different projections.
2. The prior year deficit appropriation in the 2006-07 budget was \$67 million; we are not sure yet if Budget properly accounted for that-we think they did, but we are not certain at this point. We are waiting for details from Budget on this.
3. Budget projects a \$5.8 million deficit for fiscal year 2007-08; Fiscal projects a \$29.8 million deficit. And our deficit projection could grow based on the lack of collections we are seeing. Again, we are waiting for more details from Budget to see if we can reconcile our different projections.
4. To get to a zero balance as of June 30, 2008, Budget projects:
 - a. A net \$9 million more in property sales this fiscal year. In fact, this list of transactions is before your Honorable Body right now. You should note that \$10 million in land sales on this list involved city owned property being sold to the Water and Sewerage Department we understand for the Combined Sewer Over flow project, a Federally mandated project. At a minimum, Council needs to see the Board of Water Commissioners'

approval supporting these transactions. Fiscal sent out questions on the property sales and we are waiting for responses.

- b. A net extra \$7 million as a result of the tunnel deal. The Mayor expects the City will receive \$65 million from this transaction this fiscal year, which is \$7 million than the \$58 million figure in this year's budget representing the fiscal stabilization bonds. The status of the tunnel deal will be discussed a little more in detail below.
- c. A \$25 million Police and Fire pension funding credit to be recognized this fiscal year because of the over-funding position of the P & F pension system as of June 30, 2007. We are currently reviewing the details of this, and we question whether this is a prudent measure to take given that this credit would be unavailable to help the pension system in the future when the investment market goes south, and cause the system to face an unfunded position. Council should note, too, that the Mayor budgets an \$18 million P & F pension credit in 2008-09 to help keep the General Fund expenditures lower next year. **We classify the use of a pension credit as a one-time budget gimmick the Mayor wants to use for two years.**

Although we show Budget's numbers ending up with a \$100,000 surplus at June 30, 2008, the department projects an \$834,000 surplus as of June 30, 2008.

We also understand that Budget is counting on a reimbursement of \$7 million in 2007-08 as a result of the City of Detroit overpaying the City of Hamtramck in income tax revenue from the GM Pole town deal back in the eighties. We are exploring this further also.

If we continue to have unresolved issues regarding the Mayor's prior year deficit appropriation of zero by Executive Session, we in Fiscal will be forced to recommend an amount that should go in the prior year deficit appropriation for next fiscal year. Obviously, this puts Council in a very awkward and unfortunate position.

Tunnel Deal

As your Honorable Body knows, the Fiscal Analysis Division has a number of outstanding questions regarding the tunnel deal. We understand the Administration is addressing our questions and concerns as we speak.

But there are some key points we would like to make here:

- A. The Administration is seeking Council's approval to establish the creation of the Detroit Tunnel Authority under State Act 196 within a week. We would like our questions on this establishment addressed before Council takes action. We respectfully request that your Honorable Body hear from your Research and Analysis Division on the creation of this authority before you act as well since we understand RAD has a number of critical issues

regarding this. There is an Interlocal Agreement between Windsor and Detroit that would establish the Detroit Tunnel Authority as a public transportation entity that needs to be addressed as well. Once Council feels Fiscal's and RAD's concerns have been addressed, we in Fiscal would recommend you consider establishing the creation of the Detroit Tunnel Authority in order to show Windsor the seriousness of moving towards finality with this transaction. It appears the City of Windsor wants to move on this in order to keep the tunnel in the hands of the public to avoid a private entity gaining control of either side of the tunnel.

- B. The Administration wants the Council to approve the purchase agreement that would transfer the title of the Detroit side of the tunnel and appurtenances to the Detroit Tunnel Authority for \$65 million. We have a number of questions on the purchase agreement, and I suspect RAD will have a number of concerns as well. The Administration explains the purchase agreement becomes null and void if the City does not receive the \$65 million.
- C. We understand the Detroit Tunnel Authority would enter into a Joint Operating Agreement with the Windsor Detroit Tunnel Corporation for the joint operations of the tunnel. The transaction is set up this way in order for the cities to avoid having to pay taxes on the transaction. Council should note that the City of Windsor has already transferred its half of the tunnel to the Windsor Detroit Tunnel Corporation. We understand a legal opinion on the taxation matter is in the works, and Council should receive a copy before May 27, 2008, the last date you vote on the budget.
- D. To add to the complexity of the tunnel transaction, the City of Windsor is seeking a loan application with the Province of Ontario, who would in turn loan the \$75 million to the Windsor Detroit Tunnel Corporation, who would in turn loan the \$75 million to the Detroit Tunnel Corporation, who would in turn take out \$10 million to pay for an insurance policy on the \$75 million loan and pay transaction costs, including legal and financial advisory fees; and then, the Detroit Tunnel Corporation pays the City \$65 million for the title of the tunnel and appurtenances.
- E. Goldman Sachs used the income approach, using projected tunnel revenues over 75 years amounting to \$1.6 billion, to come up with a present day value for Detroit's side of the tunnel, which value ranged from \$55 million to \$85 million. So, \$75 million is close to the high-end. But I do ask why should not the Detroit Tunnel Authority receive the \$85 million if in fact the Detroit side of the tunnel revenues is going to pay for the loan. But, it is unclear at this point if the revenues from the Windsor side of the tunnel are also going to be used as collateral to pay back the \$75 million loan.
- F. Obviously, City Council would have to approve the financing transaction by May 27, 2008, the last day you have to vote on the 2008-09 budget.
- G. And then the last piece is both Federal governments, the U.S. and Ontario, signing off on the deal.
- H. The Administration explains that this tunnel transaction scenario is set up this way in order for the City of Detroit to treat the entire \$65 million in this year's budget. We asked for the accounting rule that supports this.

If your Honorable Body is again not comfortable with the tunnel transaction, we in Fiscal would again recommend you put in fiscal stabilization bonds in the budget, and put an amount in the prior year deficit appropriation, in order to keep the 2008-09 budget in balance.

Observations for FY 2008-09 Budget

In addition to the concerns outlined for the prior year deficit appropriation, including the tunnel deal, we mentioned in the beginning of this report that we do see some soft spots in the proposed 2008-09 budget. The soft spots we see are:

1. We understand an \$18 million Police and Fire pension system credit is taken to lower the City's contribution to the pension system in 2008-09 because of the system's over-funding position. Again, we have concerns about this as this impairs the system's financial credibility in the long run. We also wonder what the P & F pension trustees may want in return for this one-time budget gimmick for the General Fund, such as some type of pension benefit that eventually would increase the City's contribution to the P & F pension system.
2. We understand the Mayor has budgeted the use of a \$25 million GDRRA bond reserve to reduce the last GDRRA bond payment of approximately \$85 million in 2008-09. This may be legitimate; but we want to see more detail.
3. We also understand the Mayor is banking on the use of \$25 million that is now in an escrow account with DTE Energy that was set up during the early stages of the GDRRA transaction requiring GDRRA to deposit some of its steam sales into this account to help protect DTE Energy from fluctuations in energy sales from GDRRA to DTE. The Mayor wants to also use this money to reduce the last GDRRA bond payment. But, it is our understanding that if these monies are used earlier than 2016, the monies have to be used for capital expenditures. Again, this may be legitimate; but we need to see documentation substantiating it, and we again wonder what DTE Energy is looking to get out of the City while agreeing to relinquish this escrow money.

We also request that the Council receive a five-year forecast from the Budget Department, hopefully, by Executive Session. This gives a plan as to what to expect in future budgets.

We also ask that Budget and Finance be amenable to establishing a revenue consensus process with Fiscal in order to come to a meeting of the minds on revenues much earlier than the budget process. This could save a lot of time and enable Fiscal and Council to spend more time on budget policy issues during budget.

We are happy to answer any questions City Council may have.

cc: Council Divisions
Auditor General's Office
Ombudsperson's Office
Norman White, Chief Financial Officer
Pamela Scales, Budget Director
Anthony Adams, Deputy Mayor
Kerwin Wimberly, Mayor's Office

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